economic trends

July 2012

Alberta economy continues to weather through global uncertainty

Despite a difficult global environment, Alberta's economy continues to perform very well. The province has posted strong year-to-date performance across most economic indicators. Boosted by employment and income gains, consumers have sharply increased spending. Construction and business output also remain strong, although a recent moderation in oil prices has subtracted from export growth. The InFocus takes a closer look at the global economy and outlines why risks are more elevated than usual.

Key Indicators — All indicators seasonally adjusted unless otherwise indicated.

Indicator	Latest Month	Value	Change year-over-year (y/y)
Employment (thousands)	June	2,144	2.7%
Unemployment Rate	June	4.6%	-0.9 p.p.
CPI Inflation	June	1.3%	-0.8 p.p.
Retail Sales	May	$5.73B	+8.9%
Housing Starts (annualized)	June	33,500	+41.9%
Rigs Drilling (unadjusted)	June	139	-7.3%
Manufacturing Shipments	May	$6.1B	+6.3%
Exports	May	$7.8B	+3.1%

Source: Statistics Canada, CMHC. p.p.= percentage points.

Global Economy

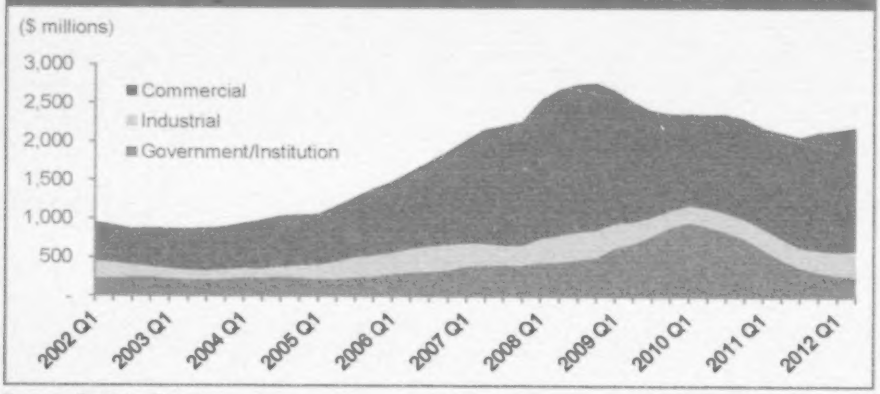
Global growth expected to slow in 2012

The global economy continues to feel the effects of the ongoing Eurozone debt crisis. Concerns have spread to Spain and Italy, while growth in emerging economies has slowed. In the US, there are signs of life in the housing market, but the labour market remains weak and uncertainty over the fiscal situation persists. In Canada, economic growth has moderated and elevated household debt remains a concern. This month the International Monetary Fund (IMF) slightly downgraded its outlook for global growth to 3.5% this year following a 3.9% increase in 2011. The InFocus on pg. 3 sheds more light on recent global economic developments.

World oil prices remain volatile

Oil markets have reacted to uncertainty in the global economy over the last three months. WTI dropped over $US20/bbl in May and hit a 10-month low in late June before a modest rebound in July. Prices this month averaged about $US88/bbl as of July 26, up from $US82/bbl in June. Weaker global growth, signaling lower demand for oil, and production increases in a number of regions have contributed to an easing of prices despite sanctions limiting exports from Iran, one of OPEC's largest producers.

Chart 1: Alberta Non-Residential Construction



Source: Statistics Canada

Business Sector

Business output healthy, but growth moderates

Lower oil prices have started to weigh on the value of Alberta's exports, as expected in June's Economic Trends. For the second straight month, Alberta's exports fell in May, by 6.6% to $7.8 billion due primarily to lower prices for energy products. This was partly offset by gains in machinery and equipment, which rose 14.7%. Despite the monthly drop, exports still remain above last year's levels and are up a solid 12.3% year-to-date.

A similar trend played out for manufacturing shipments, which fell 2.6% from April to May. Refined petroleum and petrochemical shipments were the main drag, again reflecting falling prices. Also contributing to the decline was the planned shutdown at Imperial Oil's Strathcona refinery, which was completed mid-July. However, even with the decline, the manufacturing sector has posted a solid 11.1% increase in shipments year-to-date.

Construction picking up

Construction activity in Alberta remains robust. Aided by strong inflows of migrants, housing starts were up an impressive 42% year-over-year (y/y) in June and by 50% through the first six months over last year. The value of non-residential construction continued to improve in the second quarter of 2012, rising 1.9% and posting the first

year-over-year growth (+3.3%) since the first quarter of 2009. The quarterly gain was driven by commercial spending, including construction on office and retail buildings and living accommodations associated with oil sands projects. Institutional and government spending continue to weigh on overall non-residential construction, dropping to pre-recession levels in the second quarter.

Further construction gains are expected, as the total value of building permits rose again in May by 7.6%. Through the first five months of 2012, residential permits are up 23.1% compared to the same time last year, while non-residential permits have risen 14.4%.

High expectations for farm crop receipts

This summer has provided a favourable backdrop for high returns to crop producers in 2012. The prairies have been hit with waves of heat and moisture, making for strong growing conditions. Meanwhile, drought is plaguing other major producing regions in the world, including the US and parts of Europe. This has resulted in higher prices for corn, soybeans, and grains. Statistics Canada has reported record acres of canola and larger acres of wheat, peas, and barley planted this year in Western Canada. Building on a record first quarter for crop receipts, Alberta crop producers are on track for much higher revenues in 2012.

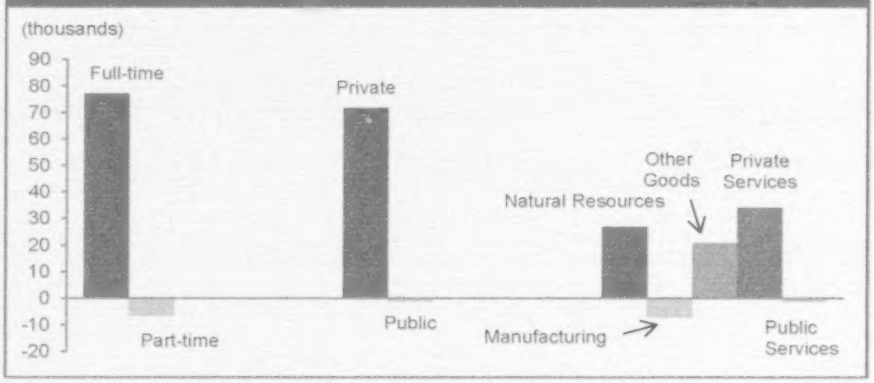
Household Sector

Labour market remains strong despite pullback in jobs last month

Alberta posted its first jobs decline in four months. Following growth of over 20,000 in April and May, employment fell 8,600 in June. The losses were concentrated in part-time positions and in select industries, notably accommodation and food services. Despite the employment decline, 2012 jobs continue to track well ahead of last year. Employment in the first half is 3.4% above the same period last year, the highest growth among the provinces. The goods sector saw a particularly large gain of 7.4% in the first half, led by a 18.2% job gain in the oil, gas, forestry and fishing industry.

Alberta's labour market has tightened. The unemployment rate is lowest in the country at 4.6%, down from 5.5% the same month last year. Alberta has posted an unemployment rate below 5% for three straight months for the first time since 2008.

Chart 2: Alberta Employment Growth in First Half of 2012*



Source: Statistics Canada *Jan-June 2012 compared to Jan-June 2011.

Alberta's consumers boost economy

A robust labour market and inflows of new migrants have contributed to more consumer spending in Alberta. Retail sales hit a record high in May of $5.73 billion, 8.9% higher than last May and bringing the year-to-date increase to 9.4%. This represents the fastest growth in retail sales in Canada. Much of Alberta's retail sales are being spurred by car and truck purchases, which were up 28.5% y/y.

Earnings growth moderates

Alberta earnings remain the highest in Canada, although earnings growth has eased in the early part of 2012. In the first five months, average weekly earnings increased 2.4%, a deceleration from the 4.1% pace set last year. This reflects a leveling off of hours worked and somewhat weaker gains in hourly earnings.

Inflation remains in check

Alberta's inflation rate continues to be among the lowest in the country. After a May reading of only 0.4%, consumer price inflation returned to a more normal level of 1.3% in June, as falling energy prices exerted less drag on the overall rate. In the first half of 2012, price pressures have been contained: both headline inflation and inflation excluding the volatile food and energy components have averaged 1.5%. Weak growth in housing and vehicle prices, along with lower energy prices, continue to keep inflation subdued.

Moving forward, it may be difficult to maintain inflation readings below 1.5%. Lower energy prices have already subtracted from inflation and are unlikely to have the same moderating effect ahead. In addition, drought conditions in the US should put upward pressure on food prices, while there is a risk that housing price gains could pick up given recent improvements in the housing market. However, price gains for homes have stayed fairly modest: year-over-year growth in new house prices was 1.0% in May and 2.5% for resale homes in June.

Foreign investment helps keep Canadian dollar elevated

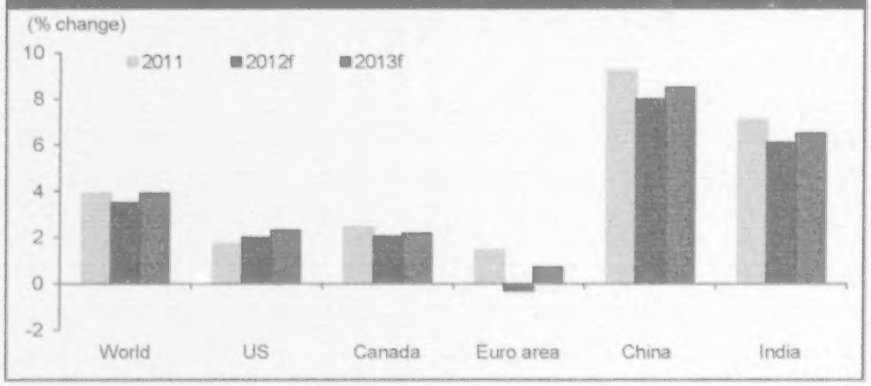
Amid heightened global uncertainty, foreign investors are pouring money into safe haven countries, including Canada. Statistics Canada reports that foreigners purchased a record $26.1 billion of Canadian securities in May. Of this amount, the majority ($16.7 billion) were in Canadian bonds, followed by money market instruments ($7.3 billion) and equities ($2.1 billion). With a relatively strong government balance sheet, Canada is luring investors who are looking to buy safe debt instruments.

The inflows to Canada have driven down 10-year bond yields to record levels of around 1.6%, and helped keep the dollar elevated at just below parity with the US dollar.

Headwinds from Europe slow global economy

Global growth is expected to slow this year amid ongoing turmoil in Europe. The debt crisis has spread to Spain, where the economy has weakened further and the banking system is under stress. A resolution to the crisis remains elusive, despite recent actions. The latest bout of uncertainty has pushed bond yields higher in troubled economies and led to a flight to safety in other markets, including Canada and the US. Mainly reflecting turmoil in Europe, the IMF has slightly downgraded its forecast for global economic growth, to 3.5% this year following a 3.9% expansion in 2011.

Chart 1: Real GDP Growth



Source: International Monetary Fund, July 2012 update

Europe

Debt crisis continues; remains key downside risk to global economy

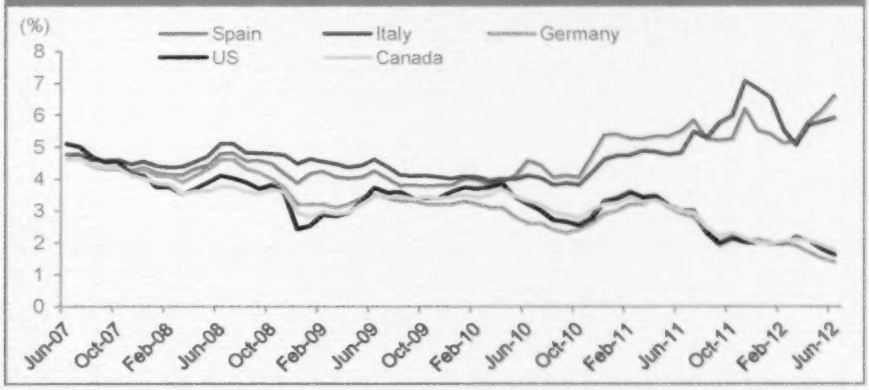
The Euro zone economy continues to stumble, as problems have spilled over to several countries. Spain is a recent victim in the crisis. Strains in the country's banking system and concerns over its languishing economy have pushed 10-year Spanish bond yields to record levels of over 7.5% this month. Spain's economy is shrinking and its unemployment rate has hit depression-like levels of 25%, making it even more difficult to meet its growing debt obligations. Italy is also a concern among investors given its rising debt levels and an economy that is expected to contract. Italian yields are nearing the 7% threshold, which many analysts view as unsustainable.

Outside the Euro zone core, problems continue to linger in Greece. While the election of the pro-bailout majority helped calm investors, serious questions remain over the government's ability to meet bailout conditions. Greece's economy has fallen by almost 20% since the crisis began and a Greek exit from the euro zone remains a threat.

Policy makers have moved to stabilize the crisis and restore market confidence. Recognizing the need to spur growth, European leaders have signed a growth pact promising €120 billion in stimulus spending on infrastructure and employment programs. They have also committed up to €100 billion to recapitalize Spainish banks, and laid the groundwork for a single banking regulator and direct capital injections through the European Stability Mechanism. The European Central Bank (ECB) has acted by lowering its policy rate this month to encourage lending.

Market reaction to these policy actions has been cautious. Investors are still wary, with market rallies after new policy announcements proving short lived. This month the IMF downgraded its Euro zone outlook to -0.3% growth and urged leaders to "establish a banking union and move toward more fiscal integration." A long-term solution to the crisis remains elusive.

Chart 2: 10-year Government Bond Yields*



Source: Central Banks, Haver. *Monthly averages

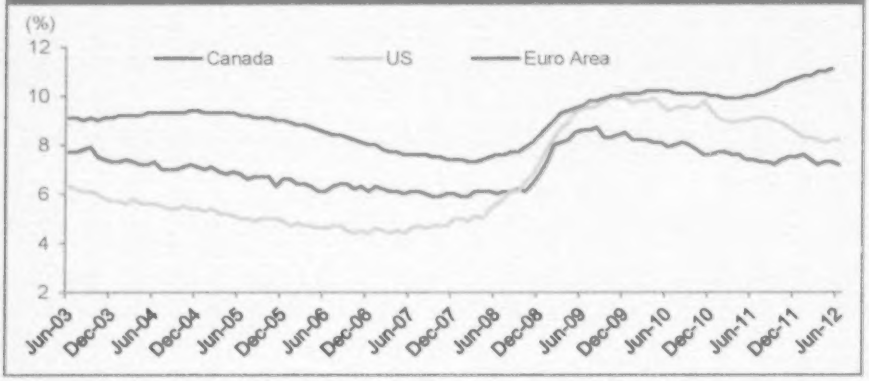
Emerging Markets

Growth slows amid European woes, pressure on domestic demand

The situation in Europe is creating ripples through the global economy, including the fast-growing emerging markets. In China, GDP growth has eased for the last 7 straight quarters and is expected to come in around 8% this year, a marked slowdown from the 10% average pace over the previous three years. Declining demand from advanced economies, particularly Europe, is in large part to blame for weaker growth. Consumers and businesses are also feeling the pinch from previous rounds of monetary tightening used to contain inflation and concerns of an asset price bubble.

The Chinese central bank has reacted to the slowdown. It lowered bank reserve requirements in late 2011 and early 2012

Chart 3: Unemployment Rates



Source: Statistics Canada, US Bureau of Labor Statistics, Eurostat, Haver

in response to the spreading debt crisis in Europe and slowing domestic demand. It then lowered its prime lending rate by more than 50 basis points to 6% in June and July of this year. Unlike many advanced countries, China has room to maneuver further by lowering rates or through fiscal stimulus.

India has seen its economy slow even more than China, with GDP growth hitting a near three year low of 5.5% (y/y) in the first quarter. Persistently high inflation and a large fiscal deficit have weighed on the Indian economy. Direct investment has also taken a hit in recent months, contributing to a 20% depreciation of the rupee against the US dollar over the last year. However, a depreciating currency could propel exports, and the Reserve Bank of India has significant room to ease monetary conditions if inflation cools.

Other emerging economies have also seen growth decelerate. In Brazil, for example, GDP growth has slowed for nine straight quarters while inflation has softened. As in other emerging economies, Brazil's central bank has eased monetary policy; its policy rate has dropped 4.5 percentage points in just the last year.

North America

A period of modest growth

The US economy continues to grow at a sluggish pace, held back by a weak labour market and fiscal restraint. Second quarter GDP growth eased further to 1.5% after a 2.0% reading in the first quarter. After a strong start to 2012, job creation has slowed to a crawl, with just 75,000 jobs created per month on average between April and June. In response to the weak economic data, the Federal Reserve has decided to continue Operation Twist: a program of buying long-term government bonds in order to lower long-term interest rates. It has also maintained a conditional commitment to keep rates at exceptionally low levels until late 2014.

There are some signs, however, that the long-struggling housing market may finally be turning the corner. Housing starts in the US have averaged 727,000 over the first half of 2012, a 26% improvement over the same period last year. Home prices have started to increase in selected cities, which could buoy further housing gains and consumer spending. US economic growth of around 2% is expected this year and in 2013.

A key uncertainty in the US outlook is the direction of fiscal policy in the face of the looming November federal election. The bipartisan budget "super-committee" entrusted to make budget cuts before the next debt ceiling vote has failed to reach an agreement. A political impasse would impose automatic cuts of US$1.2 trillion to defense and domestic spending, putting additional fiscal drag on the US economy.

In Canada, economic growth has cooled. First quarter GDP growth came in at 1.9% for the second straight quarter, reflecting weak growth in consumer spending. The Canadian housing sector, a major source of growth in Canada in recent years, is likely to be weighed down by elevated household debt and tighter mortgage rules going forward. Policy makers have warned of overheating in certain Canadian housing markets, prompting Finance Canada to recently strengthen rules for government insured mortgages.

In the labour market, Canadian job growth has virtually stalled in the last two months after large gains in March and April. On a positive note, Canada's public finances remain in relatively good shape and the drag from fiscal restraint is not as severe as in many other advanced economies. Overall, Canadian economic growth of around 2% is expected this year and next.

With global risks elevated and inflation pressures muted, the Bank of Canada is widely expected to keep rates at 1% for the remainder of this year, but with a bias towards future monetary tightening.

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